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SUBJECT: UPDATE ON ENERGY ISSUES FROM SERBIA

REF: A) Belgrade 133 and B) 06 Belgrade 2062

SUMMARY

¶1. (U) Summary. State-owned gas monopoly Srbijagas has managed to improve its financial outlook via an intergovernmental agreement that uses old Yugoslavia clearing debt to pay gas arrears to Gazprom of USD 188.2 million, debt accumulated from 1994 to 2000. However, the company still has a debt toward Gazprom of USD 36.3 million for arrears accumulated after 2000, and management cites Srbijagas's financial weakness as the main reason why it has not moved forward on the Banatski Dvor gas storage facility, the key to providing Serbia with near-term energy security. Any decisions on the gas storage, and, longer-term, on construction of the Nis-Dimitrovgrad gas pipeline, await a new Government, which faces the dilemma of ensuring continued deliveries of gas from Russia while preserving control over critical infrastructure. End Summary

SERBIA SETTLED DEBT FOR UNPAID GAS

¶2. (U) Milan Parivodic, Serbia's Acting Finance Minister, and Sergei Storchak, Assistant Minister of Russia's Finance Ministry, on April 26 signed an agreement settling the USD 288.6 million clearing debt of the former Soviet Union towards the former Socialist Federal Republic of Yugoslavia (SFRJ). Most of the debt, some USD 188 million, will be used to pay arrears to Gazprom accumulated in the period 1994-2000, while the remaining USD 105.5 million will finance overhaul of the Djerdap hydroelectric plant on the Danube River. Interest arrears will be used to finance construction of a particle accelerator at the Vinca Nuclear Institute.

¶3. (U) Milos Milankovic, general director of state-owned gas company Srbijagas, said at a press conference on April 25 that the agreement resolved a huge burden in relations with Gazprom, although he acknowledged that Srbijagas still has debt toward Gazprom. When econ chief met with Milankovic on April 30 to discuss the agreement, he disclosed that debt to Gazprom accumulated after 2000 amounts to USD 36.2 million. Srbijagas services such debt regularly via a payment of USD 3 per 1000 cubic meters of gas delivered, with payments to Yugorosgaz, Gazprom's subsidiary in Serbia.

¶4. (SBU) When econ chief asked about progress on making the Banatski Dvor gas storage facility operational, Milankovic outlined three options for filling the storage before the upcoming winter season. The first is for Srbijagas to obtain a bank loan with GOS approval, or even a guarantee. Although banks are ready to do business with Srbijagas, Milankovic said, this option is difficult because of the company's weak financial position. He disclosed that Beogradske Elektrane, Belgrade's district heating company, alone owes Srbijagas some RSD 2.7 billion, or close to USD 40 million; and Srbijagas owes NIS Gas (the former gas division within state-owned

oil and gas company Naftna Industrija Srbije-NIS) some RSD 3.3 billion, or close to USD 50 million.

¶15. (SBU) The second option would be a straight cash transfer from the new government, just as Srbijagas obtained EUR 11.5 million from the government to complete equipping of Banatski Dvor. The third option - and according to Milankovic, the most favorable - would be a strategic partner for Banatski Dvor. Milankovic said that Srbijagas had already raised this possibility with Gazprom, Yugorosgaz, Hungarian MOL, Austria's OMV and Gas de France. (MOL's director of strategy on April 27 expressed willingness to invest in Serbia's storage or lease Hungarian storate to Srbijagas.)

¶16. (SBU) Milankovic told econoff that he is urging the GOS to resolve this question by the end of May; otherwise, the chance to store gas at Banatski Dvor for the coming winter will be lost. He said that some USD 40-50 million is needed for cushion gas and for some 50 million cubic meters of gas that would be available for winter use. The cost had been estimated previously at some USD 70 million, but Milankovic said that Srbijagas can cut the cost by using domestic natural gas, which is lower quality but 20 percent cheaper, rather than Russian gas, for cushion gas. (Note: Srbijagas pays close to USD 250 per 1,000 cubic meters for Russian gas, in addition to MOL pipeline fees.)

¶17. (SBU) Milankovic said that he sent an official letter to the Ministry of Energy at the beginning of the year proposing these three options for Banatski Dvor and seeking Ministry assistance - urgently - in finding a solution. Yet he said he has never received a reply; moreover, Assistant Minister Slobodan Sokolovic, a technocrat who oversees gas and oil issues, never saw Milankovic's letter, the Srbijagas director said. Milankovic, a member of former finance minister Dinkic's G17 Plus party, indicated that political issues play a part in the lack of cooperation with the Ministry. (Minister Naumov is a member of Kostunica's Democratic Party of Serbia.)

¶18. (SBU) The political issues go deeper than distrust within the coalition. Milankovic sits on the four-member board of Gazprom-linked company Yugorosgaz as Srbijagas representative; he mentioned that, for the last two months, he has been under constant pressure from Yugorosgaz to agree to certain business proposals. While he would not disclose specifics, it was clear that he regarded these as corrupt.

¶19. (SBU) Milankovic said he resisted such pressure from Yugorosgaz and complained directly to Gazprom; the Gazprom directors then supported him. Milankovic said that Bosphorus Gas, a Turkish company partly controlled by Gazprom, really is calling the shots in Yugorosgaz. Bosphorus Gas controls Centrex, an Austria-based company that owns 25 percent of Jugorosgaz. (At the same time, Gazprom had insisted in December that Srbijagas to sign the 2007 gas supply agreement with Yugorosgaz as a condition for signature of a Memorandum of Understanding on extending the Blue Stream pipeline though Serbia.)

¶10. (SBU) Regarding a pipeline connecting the Serbian and Bulgarian natural gas systems, Milankovic said that even the Russians are waiting for a new government before deciding how to approach the Nis-Dimitrovgrad pipeline. He added that, in his opinion, the Bulgarian gas company has not shown much interest in the Nis-Dimitrovgrad project. Milankovic mentioned that Srbijagas had also started talks with Croatia about possible construction of 60 kilometers of gas pipeline parallel to the existing oil pipeline that links Croatia and Serbia, to enable gas transit between the two countries.

¶11. Comment. (SBU) Serbia's energy policy is constrained as much by internal disarray as it is by Russia's interest in acquiring energy sector assets here. Banatski Dvor is an example of a project that could move forward quickly with government approval; given ample privatization receipts, money is not a problem. As the key players in the new government emerge, we will lobby behind the scenes for a sensible policy that focuses on energy security and market-based solutions. End comment.